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Regions Financial Corp. (RF)

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CORPORATE PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Unverified Participant

Great. Moving right along, buckle down [ph] with (00:00:04) six or seven or eight banks in a row before lunch. Very pleased to have Regions Financial with us today. From the company, we have John Turner, CEO. We have, no relation, David Turner, CFO; and Deron Smithy, the Treasurer.

There is a slide deck the company posted this morning. We're not going to take you through the slide deck, but look at it. There are some interesting charts and graphs in there. This is more of a fireside chat format. Throughout the fireside chat, feel free to raise your hands. I'm happy to take questions during it if we're on a topic that you're interested in or even a topic we didn't get to yet.

QUESTION AND ANSWER SECTION

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Maybe the best place to start because you had some interesting slides in the deck, and it's kind of one of the hotter topics around the conferences kind of just net interest margin and deposit costs. And in the slide deck somewhere you had in the earnings call, you talked to the margin kind of staying in the 3.40-ish or I guess you had 3.45% margin in the second quarter, kind of reiterating you expected to be in the 3.40% range in the fourth quarter and then actually begin to increase in the beginning of next year. And you kind of had that on the earnings call, kind of reiterated the guidance today despite the fact you've seen a much greater than expected drop in the 10-year treasury yields. At the same time, you've had deposit costs coming down in the last several months, which was in contrast to some other banks which have seen deposit cost to continue to increase. Maybe talk to in terms of how you manage the balance sheet against the current interest rate backdrop and maybe after that touch on how you manage your deposit base?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Okay. I'll start, let Deron chime in. So, thanks for having us. We had anticipated this environment happening that is the economy slowing down, [ph] a little more (00:01:59) accommodation coming from the Fed. We had anticipated that happening in 2020, not 2019. So there was a little bit of disconnect in terms of the economic performance and Fed policy. So our hedging program that we started to put in almost two years ago really starts in 2020. We're a little bit more exposed in 2019.

A couple of things we've been able to do, though, is really watch our deposit costs. We gave you a slide in the deck that shows our expectation for deposit costs coming down in the third quarter. We have, on the consumer side, a little more programmatic in terms of how we set deposit costs. On the commercial side, which was a big part of our beta going the other way in the first quarter, were short-term contracts with large customers that we were able to adjust pretty quickly. And that's why we had confidence that we were going to be able to bring deposit costs down. We saw that at the latter months of the second quarter. We disclosed it into the third quarter and that's where we were able to offset a bit of the pressure that we have on the rate environment that has changed since earnings. And we're giving you the approximate 3.40% in the fourth quarter.

Do you want to elaborate on how we think about the balance [ph] sheet (00:03:18)?

M. Deron Smithy
Treasurer & Executive Vice President, Regions Financial Corp.

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Yeah, so, obviously, we've been thinking about managing that short rate exposure. Obviously, our hedges kick in in early 2020. We've messaged that we think that we're not defenseless in 2019. We do have the ability to continue to manage deposit costs. And we think that that will allow us to keep the margin relatively stable, maybe a couple of basis points, if we were to get an additional ease, couple of basis point impact to the margin per ease. And then once we start 2020, we're relatively neutral to changes in the short rate.

Obviously, you mentioned the long end of the curve coming down and that really impacts us in two ways. One, and really the preponderance of the impact is being driven by new business originations across our lending businesses, the fixed rate term lending in the mortgage space and then in C&I term lending. And so over time, the long end of the curve really neutralizes what was a longer term tailwind for us that we had a balance sheet that was repricing upwards before we've messaged that we had as much as 70, 75 basis points earlier in the year tailwind from the balance sheet repricing, as new originations come on. Today, that's largely neutralized. It's a modest headwind for us on the long end of the curve.

The other impact of the long end coming down is prepayments in our securities and our mortgage business. So we think that through asset selection and through the coupon selection that given where rates are today, that's fairly manageable. We think the impact is relatively small. We've updated our slides for sensitivity and based on forwards at the end of 6/30, which really takes the long end down to in the low-1s, we think our sensitivity is in the 1% range from an NII standpoint. And it's fairly stable. It's fairly stable if we stay sort of in this area with the 10-year to modestly lower. But in terms of managing the balance sheet, we're trying to, around the edges, think about from a reinvestment standpoint of what's going on in the balance sheet, how to minimize that exposure to prepayments and just keep the position fairly stable from here.

Q

I guess one area some banks have complained about is just premium amortization. Can you just talk to the impact of that?

M. Deron Smithy
Treasurer & Executive Vice President, Regions Financial Corp.

A

Sure. So as we messaged last quarter that – so premium amortization was in the high-20s, $28 million for the quarter, I believe. We expected that to tick up a bit over the next couple quarter given the reduction in long-term rates. Again, we think we probably migrate up into the low- to mid-30s as a run rate at the current level. If we were to see the 10-year move meaningfully lower down below 1.50% into the, call it, 1.25% range and we didn't see any meaningful spread widening with respect to new mortgage origination rates, we could see that tick up into the mid- to upper-40s – 30s, sorry, not 40s.

But we think in this range, it's fairly manageable, very modest increases. 70% to 80% of our book today is economically disincentivized to prepay, that obviously if we move another 25 basis points or more lower, a greater percentage comes into the money, so to speak. We think the premium level is down materially from the last declining rate cycle. We've been focusing on not adding a lot of premium to the book. And so we think the increase in premium am, as long as we stay roughly in this area, is pretty manageable.

Q

Helpful. And then, I guess, in looking at the slides, your revenue growth guidance, I guess, previously was kind of lower end of 2% to 4%. Now you're kind of solidifying it at 2%. Is it the kind of the modest change in kind of the NII outlook or is there something else?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

That's the primary driver. Of course, 65% of our revenue comes from spread, certainly having pressure there from the rate changes since earnings. But we're also having some benefits on NIR with mortgage. Mortgage is going to be strong for, I think, the industry this quarter. There'll be a little bit of get back on CVA/DVA adjustments, fair value adjustments. But net-net, we feel good about NIR. So, that change – we are already to the low end of the range. We just thought it was more prudent given we're another quarter closer in that approximately 2% was the right answer for investors.

Q

And you guys have been talking about low- to mid-single-digit-type loan growth for the year. Given a lot of the uncertainty with trade and tariffs and just the overall economic outlook, at least if you read the papers, just maybe talk to in terms of what you're hearing from your borrower base, kind of where you're seeing growth, where you maybe have some buzz?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Yeah. Our customers are generally still optimistic, I would say, but more cautious particularly given some of the volatility and conversations about trade and tariffs. Pipelines have been steady. I would say they're good, not great, [ph] seeing (00:08:55) a little uptick in the last 30 days, plus or minus. Production has been pretty good, growing commercial loans. We have [ph] some of our (00:09:05) portfolios particularly on the consumer side. Within commercial, we're seeing growth in a couple of our specialized industries groups, specifically technology and defense and financial services where we have some real expertise. And we will continue to, I think, see modest growth which will offset some of the runoff that we have in other portfolios.

Q

I guess as you talk to your borrowers as they can, to plan to think about next year, just any thoughts on kind of the current environment kind of restraining kind of CapEx spending and the like and how do you kind of go about kind of thinking about what we should expect?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

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Yeah. I mean we think the economy is still sound. As I visit across our 15-state footprint and customers that I've talked to have solid 2019, they feel good about 2020. The biggest constraint on the economy still is the availability of qualified labor. And then I think some reluctance on the part of businesses to invest given the uncertainty about the impact of tariffs and some of the volatility, and given the conversation the Fed's having about cutting rates, if you're a business owner, you think the economy is good. But if the Fed's going to cut a rate, what message is that sending to business today is the Fed knows something business doesn't know about the overall economy. And I think that's creating some pause.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

I add to that. As I mentioned, we saw this coming of slowing down and we positioned the balance sheet with hedges to protect us so that we would not have to power through to get NII growth through unusual loan growth. So we don't need a lot of growth to propel us into 2020. We need some, but we think going into the 11-year expansion trying to power through and outgrow and have unusual growth was going to introduce credit risk that we didn't want to have. So we're confident that we're going to get the kind of growth that we've planned for.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

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And to that end, if you look back a couple of years, I would say we've done three significant things in anticipation of slowdown. First was the hedging strategy that we've talked about. The second was we've been derisking our portfolios. We've exited certain businesses, indirect auto, consumer, indirect unsecured, medical office building. We've changed the composition of our real estate business and reduced our reliance on it, all to position the balance sheet to be much stronger and more resilient through challenging times. And then we introduced our Simplify and Grow initiative now back in the latter part of 2017, first part of 2018 again to help us begin to drive efficiencies in our business in anticipation of a time when we weren't going to benefit from rising rates and credit was going to begin to normalize. So all three of those things were ideas that we developed over the last, call it, 24 to 36 months in anticipation of where we are today. We think we're well positioned.

Q

I want to come back to Simplify and Grow in a second, but you talked about derisking and you've kind of got at three or four areas that you've, I guess, had some concerns about. Is there – I guess is – what is the kind of next in the balance sheet you're keeping an eye on, not necessarily maybe you would jettison it, but where portfolios or geographies that you maybe have a bit more trepidation than others?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Well, we're always focused on investor real estate, particularly given our history. We think we've reconstituted that business, built it around really quality professional real estate bankers, really solid customers, good markets. Our exposure is very manageable relative to our peers. It's one of the lowest. It's also a business that is producing good fee revenue and deposits. It's a solid business.

Beyond that within commercial where we have a leveraged portfolio that we continue to rigorously examine and service and [ph] stress (00:13:15) on an ongoing basis, we've called out fast casual in the restaurant sector and the energy portfolio, we naturally have energy exposure. It is less than it was in the energy when the energy recession began, but it's still an important business to us and one that we'll continue to be in. We've again remixed that portfolio, reducing our [ph] auto services (00:13:39) exposure down to about 13% of the total exposure, largely in E&P and midstream business, but one that we're watching given the volatility in that commodity.

Q

Helpful. And then on Simplify and Grow, I guess you never actually told us kind of what metrics you were tracking towards from a revenue or an expense standpoint, but I guess where are we in that program? Has it kind of lived up to your expectations? How much more benefit do you expect from that?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Yeah. So one of the reasons we didn't tell you what to expect was we didn't want the program to have a beginning and an end. It was about creating a culture of continuous improvement. So we get better as we say every day at what we do. We have benefited significantly from the program. I would say that we've realized less than 50% of the business – 50% of the opportunity that we ultimately envision. We began with about 40, plus or minus, initiatives. We accomplished 12 to 15 of those. We now have 60.

So the point is as we're completing certain initiatives, we introduce new ones. And so we might be talking about it next year here at this conference and I might say again that we've realized less than 50% of the benefit, because we really view it as continuous improvement and we do think it has had a really significant impact. It's allowed us to make investments in our business and people, capabilities and technology and markets, all while not increasing our expense base.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

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I'll add that we didn't give very specific here is how much revenue, here is how much expense. We had just come off two expense programs as you recall, and having this continuous improvement program was real important. It did manifest itself in us giving some metrics of positive operating leverage each year and efficiency ratio target that we laid out below 55% in our third year. So it's because of the process of continuous improvement that we're able to see that and we still have that challenge for us that we laid out at the Investor Day just, what, eight months ago.

Q

So I guess in thinking about that below 55% efficiency ratio, if you kind of look at the current backdrop, say, the rate environment gets more challenging, economy slows as some predict, how confident are you, you can actually get to that figure? And maybe in the context, maybe talk about some of the bigger opportunities in Simplify and Grow yet to be realized?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

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Yeah. I would say that we're, like I said, eight months into the program. Obviously, the rate environment's very different than we thought. Very similar to the last three-year program, if you remember, rates had dipped down. And we had a three-year plan that ended in 2018. The 10-year finished about where we thought it would be, but along the way, it declined. And so we had to do something else. We had to call [ph] it inaudible (00:16:44) and we did that through a couple of expense programs, and we've met the objectives that we laid out. That would be our plan this time is to continue to pull different strings to try and achieve the goal.

To the extent we have a low rate environment that persists through all three years, achieving a 55% or below efficiency ratio would be very challenging. I wouldn't call it out of the question, but they'd be extremely challenging. The low-hanging fruit on expenses have been picked. The way we get better today is making banking easier for our customers. It helps generate revenue, but it also takes out processes and steps and head count, so we get to win both ways. And so the question is, if rates are going to be here lower, we just put that much more pressure on ourselves to continue to evolve quicker than we otherwise would have to try and achieve the goals that we laid out.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

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We underspend FF&E. David talks about reductions in a number of branches still an opportunity, and then using technology to evolve our back office processes to be largely automated so that manual processes are largely exception in nature. We think there's a real opportunity to do that. As an example, within our call center, we're using artificial intelligence, the IBM Watson product. We've been able to answer 2.5 million calls in the last 12 months. That's effectively the equivalent of we estimate about 50 FTE that would have been handling those calls otherwise. That's the success we've had early on that we see an opportunity to really build on through the use of artificial intelligence [indiscernible] (00:18:23) work we're doing.

Q

Okay. I guess there's a big merger going on in your footprint between BB&T and SunTrust, moving the headquarters, coming up with a new name. A lot of employee – or it would have to [ph] hit your cost head numbers, (00:18:40) employee reduction. There's got to be some customer overlap. You would think it'd be a big opportunity to pick up some market share.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Clearly, transactions of that size are disruptive. We'd say BB&T and SunTrust, two very good banks run by very capable CEOs, they can do a great job with merger, I'm sure, and are providing really good leadership in their markets. But there will be disruption. We're seeing that and we want to take advantage of that as those opportunities arise. We have specific plans targeted at customers, targeted at associates to whether it's in Atlanta or Orlando, East Tennessee where they have a strong presence. We'll continue to focus on those opportunities. We don't forget there's disruption in other companies as well. And so our challenge to our bankers is to be actively engaged, focused on the right customers and the right opportunities. If we do those things, we are consistent in our approach. I think we'll have nice success building our business.

Q

I guess when they put those two companies together, they touted the importance of scale, the importance of having to invest in technology, and it felt like being as bigger would enable them to do that. Obviously, Regions is a byproduct of two sizable MOEs. I guess as you look out, what's your thought of another? And if you're not going that route, do you feel like you have the scale and the technology to compete, because those two – it seems like they didn't feel like that way?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Yeah. A two-part question. I'd say first, we do think that we have the scale to compete. We don't believe that increased scale is an absolute requirement for us to be effective. We're making $625 million in technology investments this year. About 42% of that will go toward new capabilities, new technology to serve customers and to help us improve efficiencies and effectiveness. I'm often asked, well, how do you know that you're successful, and I would say that we're growing consumer checking accounts, we're growing consumer demand deposits, growing consumer low-cost deposits. Our customer favorability score is some of the highest in the industry.

Half the accounts we're opening are for individuals who are 30 years of age or younger. And so, in markets like Atlanta, Orlando and Houston, where we're making investments in physical facilities, we're seeing a significant increase in new account openings. And so, we believe we absolutely do have the scale to compete. In fact, I would argue that regional banks, given the fairly flatness of our organizational structure, the fact that we are less complicated in the way we operate, we have one branch platform, one deposit system, one loan system, we can make changes more easily and less costly than many of our peers. And so, we think technology can be a real advantage for us.

With respect to M&A, we think our plans, as David talked about, will deliver outsized returns on a relative basis for our shareholders if we stay focused on the things that we can control. And so, we're not interested in bank acquisition today. We stay aware of what's going on in the market. We're obliged to and periodically review MOE opportunities or at least the concept, if you will, with our board, just as we're obliged to talk to them about who might be interested in acquiring Regions or what we think the market conditions are. But given all those things, given what we know about – and our ability to execute our plan, we think remaining independent and staying focused on the execution plan is the right thing for our shareholders.

Q

Helpful. Can you maybe talk about your interest in non-bank or bolt-on acquisitions? I know you did the Highland Associates deal earlier this year.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Yeah.

Q

So, maybe talk to what that brings you and kind of what other products, capabilities you feel like you need.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Yeah. I would say – thank you – non-bank acquisitions are something we're interested in, and we have had some success. We've acquired an M&A advisory firm a few years ago. We acquired a low-income housing tax credit syndicator. We recently announced the acquisition of a wealth management – effectively an outsourced Chief Investment Officer function, Highland Associates, focused on the not-for-profit healthcare space, which coincidentally aligns well with our oldest and I guess most well-developed Specialized Industry group, and that's our Healthcare Banking group. So, we're excited about that.

We've acquired mortgage servicing rights portfolios. That's a capability that we have. We think we're a low cost, very effective servicer. So, we will continue to look for enhancements to our business, add to – allow us to diversify our revenue, to meet customer needs and to address specific capabilities in areas like wealth management, like capital markets, like mortgage banking, where we think we have an opportunity to continue to grow.

Q

Helpful. I think this is the first time you're speaking publicly since the 10-Q was filed. One of the things that jumped out to me was your, I guess, CECL disclosure. Reserves will be up $400 million to $600 million, and clearly manageable, but I guess a 45% to 65% increase in the reserves was more than we had expected. Maybe just walk through kind of what's driving that increase [indiscernible] (00:24:15).

M. Deron Smithy
Treasurer & Executive Vice President, Regions Financial Corp.

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Yeah, sure.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

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Yeah. So, we had $400 million to $600 million we disclosed in the 10-Q that we'll have day one. We'll tighten that up as we get closer to implementation. The real driver of this is the Consumer side. Any asset that has duration on it really gets much larger reserves than another portfolio. So, for us, mortgages, HELOCs, unsecured consumer credit, far more of the reserves are being attached there. And it's just a case of, for consumer assets under an incurred loss model, those have a tendency to have a very short period of time sitting in the reserve. So, just for demonstration purposes, maybe a mortgage asset has one year of losses sitting in the reserve under an incurred model, and mortgages, I think we could all settle on being about a seven-year duration asset. So, you got seven times that in Consumer, and you keep doing that over HELOCs and unsecured credit. That's where those numbers really come from.

We're going to have to evaluate what the economy looks like at the time of implementation. So, things can change, making that $400 million to $600 million less or more. So, I talked to a lot of my peers after our release. So, we're one of the first ones that have put something out. I think you'll be surprised that we're not going to be all that different. The composition of one's portfolio does matter. So, certain of our peers that have more business services loans are going to see that kind of change that we will have, those of us that look like us that have the larger amount of Consumer will.

Q

Helpful. I think the other sentence in the 10-Q was CECL could impact Regions' ongoing earnings perhaps materially. So, I guess we kind of understand the day one impact. Maybe talk about the day two and beyond impact and how CECL impacts your decision to lend, what type of loans you're going make going forward, the duration of those loans, and your thoughts about lending to the extent that the economy faces a sharper – a downturn.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

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Yeah. So, that comment on could be material probably got more attention than we had intended. What we're trying to demonstrate though is today, as the economy begins to degrade, the pace of provisioning under the incurred loss model is far slower than under CECL, which is what FASB intended. They wanted that provision to be quicker, and I think investors perhaps wanted that as well. So, when the economy does change, you're having to make a change on the entire portfolio for life of loan losses, which makes the volatility much higher day two going forward.

Specific to your question on origination, we're going to have to wait and see. At the end of the day, we're in the business of making loans to help individuals and businesses grow. But the economics now have changed when you have to front-end losses. And so, will that change pricing? Will that change the duration of what you're willing to put on your books? So, take a mortgage loan, when we do – put a 30-year mortgage loan on the books or are we going to sell all that and just put short-term? We're going to have to figure all that out strategically.

And if we sell this to the agencies, they also have CECL. What are they going to do? Are they going to increase [ph] the fees (00:28:00) that then get passed through to the customer? So, there's a lot of uncertainty that's out there with regards to CECL and how it's going to affect the entire economy, which was one of our arguments that we're putting in the standard that's life of loan that's going to be very difficult in the transition. Over time, we'll all figure it out, but we're likely to have a little bit of volatility on the front-end.

Q

Well, I'll pause there and we can start with the ARS questions, similar to ones we asked the other bank presenters, the first one just around stock positioning. So, 25% overweight, interesting. Last year, Regions went from 7% to 29%, which was one of the larger increases of any company. So, it looks like they maintain that, although it looks like a majority [indiscernible] (00:29:13) position, which creates an opportunity.

And then, we'll go to the next one. [ph] Could have led (00:29:18) with this one. But where do you expect Regions' 2020 NIM to be? Point of reference, 2Q was 3.45%. So, we'll figure out what the buy-side consensus is. So, 3.30% to 3.35% kind of the most popular answer, followed by 3.35% to 3.40%, so, some degradation, but not too much. And I would say a little bit below that kind of 3.40s number you kind of suggested in the first quarter. You gave us some line of sight on Q1 of next year. Any thought how to think about the remaining three quarters, I guess assuming just the forward curve plays out as expected today?

M. Deron Smithy
Treasurer & Executive Vice President, Regions Financial Corp.

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Yeah. So, again to reiterate, we think around 3.40% is sort of where we end the year, somewhere in that neighborhood. And then, as the hedges kick in, depending on what the Fed has done between now and then, we think we see a modest improvement up into the low-3.40s, and it's fairly stable from there. Again, depending on what happens to the long-end of the curve, today, it's marginally unhelpful. To the extent we could get a slightly higher long-end of the curve, we could see some ability to modestly increase that over time, but it's relatively stable in this environment in the low-3.40s.

Q

I guess when you – you obviously look at the balance sheet under a lot of different scenarios, I imagine. Some people would ask me about the impact of negative rates and what happens and how you'd react in that scenario. And while I don't think that happens, there's certainly a [ph] contingency (00:31:16) that it does. Maybe talk to kind of your thoughts around that.

M. Deron Smithy
Treasurer & Executive Vice President, Regions Financial Corp.

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Yeah. So, clearly, negative rates are not helpful. And so, we've done some analysis around that and some thinking about how the business model is impacted and what are our defenses. I think at this point, I do think it's not probable, but it's something we have to think about and be prepared for. I think there's some opportunities to look – to think about are there additional hedging strategies that may seem well out of the money today, but in that negative rate environment could have some value. We'll continue to evaluate those in the context of probability and cost. But again, I think that's something we're thinking about.

Q

I'll pause there and open up to the audience for some questions. [indiscernible] (00:32:12) behind you.

Q

Just a matter of curiosity, when you calculated a loan life loss provision, what kind of modeling you're using? You're going back 10 years, 20 years? You're thinking about when we're going to lapse the biggest spike driven by the [ph] great (00:32:33) financial crisis?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Yeah. So, you utilize history, but you also utilize changes that you've made in underwriting and different – we're a completely different bank than the crisis. So, it's all about what our expectations are for life of loan going forward, leveraging history, but you don't have to just follow it without other considerations. So, we've looked over the financial crisis as to what ultimate losses were then. We've taken into account all the changes in the profiles and underwriting. We have a reasonable supportable period of two years for all of our portfolios, and from that, we'd revert back to historical norms through the life of the portfolio we have today.

Q

Sorry, another question coming from Europe and with the ESG pretty much in focus, do you disclose your exposure to [ph] gun fire and the gun industry in (00:33:32) general?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

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We don't, to my knowledge. We've got a pretty well-developed ESG program, and we think within our proxy, there are lots of ESG-related disclosures. I'm not confident though that we're providing any specific industry-type exposure today.

Q

Thank you.

Q

Hi. You briefly mentioned – talked about the leveraged loan portfolio and the risks embedded in that. Could you speak a little more to your strategy going forward? I believe in Q2, those loans were up around 5% year-over-year.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

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Yeah. So, I would say our – that portfolio is well-diversified. It is largely centered around – is built around customers that we have relationships with. There is about 25%, 26% of the portfolio that's – that are two companies that are sponsor-owned. We're not lending directly to private equity groups, but instead to companies that are potentially owned by private equity groups. That's down from a high of, I think, about 35%. So, we view that sort of enterprise value, sponsor-owned portion of the portfolio as being the most high-risk.

We are servicing that portfolio at least on a quarterly basis, in some instances monthly, so stressing it, and again, managing it to a specific concentration. We think the overall quality is good. A significant portion of it is investment grade, and it is largely – at least the higher credit exposure is underwritten by our Specialized Industries groups. We have a dedicated leveraged finance team and a dedicated enterprise valuation team as well. So, we think it's well supported by a lot of expertise and we have the right controls in place to manage the risk.

Q

[ph] The mic is right here (00:35:41).

Q

Hi. It's just interesting that you're doing scenarios for negative rates. Could I ask you if that's sort of orientated to possible scenarios like CCAR or Fed guidance, so you just want to be ultra conservative? And when you look at out of the money sort of hedges, do you think the best options is through [ph] bars (00:36:04) of the curve or [ph] these prized (00:35:58) asset classes that will give you a hedge in the eventuality of a [indiscernible] (00:36:10) how would you look at it? Thanks.

M. Deron Smithy

Treasurer & Executive Vice President, Regions Financial Corp.

A

Yeah. So, there's a lot in that question. I think we started a couple of years ago thinking about negative rates through CCAR in the process. We've continued to evaluate it. Obviously, earlier this year, we thought it was a very low probability. It's something we've spent more time thinking about lately. I think what I mentioned, the potential hedging in the derivatives space is really just again to try to put protection on that, if short rates did go negative that we would continue to benefit, because what generally happens is we do have the ability to manage deposit costs. As rates move lower towards zero, obviously that gets floored out when we get to zero. But your assets continue to reprice down. So, we would be looking to offset that exposure through the derivatives market. In terms of asset classes that may perform better in that environment versus others, I think it's still early. We haven't formed any firm opinions there yet.

Q

Additional questions? We can go to the next ARS question then. Which of these 2021 targets do you think will be hardest for Regions to achieve? Well, the efficiency ratio [audio gap] (00:38:00) most popular one by far, followed by the [ph] RO (00:38:05). I guess, David, you've mentioned that it would be challenging to get to that number in a difficult economic or rate backdrop. I guess as you sit here today and we kind of play out the forward curve and assuming no recession, do you still think that number is doable?

David J. Turner, Jr.

Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Yeah. I think that to the extent we [audio gap] (00:38:35) this low rate environment persists through all three years – so, we're into 2021, we're still here – the 55% efficiency ratio and 18% to 20% on return would be very difficult to achieve. I think that, again, we want to be realistic about the math, right, because you can do the math just like we can. But we're only eight months into this and we don't want to give up. There's still levers we can pull. The easier ones are on the expense side than the revenue side. We've already told you what our capital is going to be. We're not likely to want to pull the denominator below our comfort zone just to meet some return target. So, while we're not giving up on that realistically, both [ph] one and two (00:39:24) would be pretty challenging if [audio gap] (00:39:27).

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

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But I would say we are committed to continue to drive efficiency down and believe that over time, as an industry, we've got to be more efficient operators. We'll do that through the use of technology. We don't intend in this environment to curtail our investments, spending that we think will ultimately – technology spending that will ultimately positively impact the customer experience and the way we do business. And so, while those numbers may be more difficult to achieve in this environment, we're still committed to trying to get there. We're not going to do anything to harm the franchise, but we are going to continue to make investments that we think will enable us to effectively alter the way we do business and positively impact our efficiency ratio.

Unverified Participant

Helpful. Thank you. Please join me in thanking John, David and Deron for their time today. Next up is BB&T in this room, Legg Mason, First Hawaiian and a couple of other companies.